

Final Order Denying Refund: 04-20100543
Sales and Use Tax
For the Tax Years 2007, 2008, 2009

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ISSUES

I. Use Tax – Manufacturing Exemption – Coffee Equipment.

Authority: IC § 6-2.5-1-1 et seq.; IC § 6-2.5-3-4; IC § 6-2.5-3-7; IC § 6-2.5-5-8; [45 IAC 2.2-3-4](#); [45 IAC 2.2-5-8](#); Sales Tax Information Bulletin 11 (December 2002); Sales Tax Information Bulletin 45 (December 2002); Indiana Dep't of Revenue v. Cave Stone Inc., 457 N.E.2d 520 (Ind. 1983); Indiana Dept. of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454 (Ind. Ct. App. 1988); General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399 (Ind. Tax Ct. 1991); Indiana Waste Sys. v. Indiana Dep't of State Revenue, 633 N.E.2d 359 (Ind. Tax Ct. 1994).

Taxpayer protests the assessment of use tax on coffee brewing equipment.

II. Tax Administration – Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; [45 IAC 15-11-2](#).

Taxpayer protests the imposition of a ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is a provider of vending and coffee services. The Indiana Department of Revenue ("Department") conducted a sales and use tax audit of Taxpayer for the years 2007, 2008, and 2009. As a result of the audit, the Department assessed Taxpayer additional use tax on several items, as well as interest and penalty. Taxpayer protested the assessment of use tax on coffee brewers Taxpayer installs at its customers' premises claiming they are subject to the manufacturing exemption. Taxpayer also protested the assessment of penalty. A hearing was held on Taxpayer's protest and this Letter of Findings ensues. Additional facts will be provided as necessary.

I. Use Tax – Manufacturing Exemption – Coffee Equipment.

DISCUSSION

Taxpayer purchases coffee preparation equipment, including the coffee brewers at issue, which it installs and maintains at its customers' premises with the agreement that its customers will purchase the coffee products used with the equipment from Taxpayer. Taxpayer's customers provide all water and electricity used by the coffee making equipment.

In Indiana, a sales tax is imposed on retail transactions and a complementary use tax is imposed on tangible personal property that is stored, used, or consumed in the state. IC § 6-2.5-1-1 et seq. In determining whether tangible personal property is subject to use tax, IC § 6-2.5-3-7(a) provides that "A person who acquires tangible personal property from a retail merchant for delivery in Indiana is presumed to have acquired the property for storage, use, or consumption in Indiana, unless the person or the retail merchant can produce evidence to rebut that presumption." Additionally, [45 IAC 2.2-3-4](#) states that "Tangible personal property, purchased in Indiana, or elsewhere in a retail transaction and stored, used, or otherwise consumed in Indiana is subject to Indiana use tax for such property, unless the Indiana gross retail tax has been collected at the point of purchase." An exemption from the use tax is granted for transactions where the gross retail tax ("sales tax") was paid at the time of purchase pursuant to IC § 6-2.5-3-4. There are other exemptions from sales and use tax, including an exemption for manufacturing machinery, tools and equipment directly used by the purchaser in direct production.

In general, all purchases of tangible personal property by persons engaged in the direct production, manufacture, fabrication, assembly or finishing of tangible personal property are taxable. [45 IAC 2.2-5-8\(a\)](#). The exemption applies to manufacturing machinery, tools, and equipment directly used by the purchaser in direct production. Id. Machinery, tools, and equipment are directly used in the production process if they have an immediate effect on the article being produced. [45 IAC 2.2-5-8\(c\)](#). A machine, tool, or equipment has an immediate effect on the product being produced if it is an essential and integral part of an integrated process that produces the product. [45 IAC 2.2-5-8\(c\)](#); Indiana Dep't of Revenue v. Cave Stone Inc., 457 N.E.2d 520 (Ind. 1983). An integrated process is one where the total production process is comprised of activities or steps that are functionally interrelated and where there is a flow of "work-in-process." [45 IAC 2.2-5-8\(c\)\(1\)](#).

In applying any tax exemption, the general rule is that "tax exemptions are strictly construed in favor of taxation and against the exemption." Indiana Dept. of State Revenue v. Kimball Int'l Inc., 520 N.E.2d 454, 456 (Ind. Ct. App. 1988). The taxpayer claiming exemption has the burden of showing the terms of the exemption statute are met. General Motors Corp. v. Indiana Dept. of State Revenue, 578 N.E.2d 399, 404 (Ind. Tax Ct. 1991) aff'd 599 N.E.2d 588 (Ind. 1992) (Internal citations omitted). Additionally "[e]xemption statutes are strictly construed because an exemption releases property from the obligation of bearing its fair share of the cost of

government." Id.

Taxpayer maintains that the equipment is exempt from use tax based on Sales Tax Information Bulletin 45 (December 2002), 26 Ind. Reg. 929. Taxpayer refers to the following language from Information Bulletin 45, section III:

Generally the purchase of a vending machine is taxable. A vending machine that actually produces a product for resale is not taxable because the vending machine is directly used in manufacturing.

Taxpayer also refers to Sales Tax Information Bulletin 11 (December 2002), 26 Ind. Reg. 912, quoting the following:

The purchase of tangible personal property that will act directly on the food during preparation is exempt from sales tax.

Taxpayer acknowledges that Information Bulletin 11 discusses the application of sales tax to restaurant owners including fast food operations and caterers, but argues that if the restaurant owner can purchase a commercial coffee brewer exempt from sales tax, then it should be entitled to the same exemption.

In the case of vending machines that produce a product for sale, the vending machines and the product produced by the vending machines are owned by the same person. In the case of the coffee brewers at issue here, the owner of the coffee brewers and the owners of the coffee products used in the brewers to make coffee are not the same. The coffee is made and sold by Taxpayer's customers, not Taxpayer. The same analysis applies to the restaurant owner that purchases a commercial coffee brewer to make the coffee it serves in its restaurant; i.e., the coffee-making is the restaurant's own process.

In *Indiana Waste Sys. v. Indiana Dep't of State Revenue*, 633 N.E.2d 359, 363 (Ind. Tax Ct. 1994), the Tax Court further expounded on the "equipment exemption" providing that it is not enough that a taxpayer seeking to claim the equipment exemption acts as one part of a larger overall process that results in the production of tangible personal property. Id. The Tax Court found that the tangible personal property must be produced "as part of [the taxpayer's] own process... not as part of an alleged process of another taxpayer." Id. The Tax Court established a "minimum threshold requirement... that the taxpayer who purchases the equipment in question be the entity that uses the equipment 'for his direct use in the direct production... of other tangible personal property.' [IC 6-2.5-5-3\(b\)](#)." Id. at 362-63 (emphasis in original). Thus, the Tax Court determined that in order "to have a colorable claim for the equipment exemption" pursuant to [IC § 6-2.5-5-3\(b\)](#), a taxpayer must use the equipment "as part of its own process to produce other tangible personal property, not as part of an alleged process of another taxpayer." Id.

Given all of the above, Taxpayer's coffee brewers do not qualify for the manufacturing equipment exemption from sales and use tax.

FINDING

Taxpayer's protest is respectfully denied.

II. Tax Administration – Negligence Penalty.

DISCUSSION

The Department issued ten percent negligence penalties for the tax years in question. Taxpayer protests the imposition of the penalties. The Department refers to [IC § 6-8.1-10-2.1\(a\)\(3\)](#), which provides "if a person... incurs, upon examination by the department, a deficiency that is due to negligence... the person is subject to a penalty."

The Department refers to [45 IAC 15-11-2\(b\)](#), which states:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The Department may waive a negligence penalty as provided in [45 IAC 15-11-2\(c\)](#), as follows:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section.

Taxpayer was assessed additional use tax on several items in addition to the coffee brewers that are the subject of this Letter of Findings. Taxpayer did not have a system in place for self-assessment of use tax even though this was not the first time Taxpayer was audited for sales and use tax compliance. Taxpayer has not demonstrated that it had reasonable cause generally for not itself paying sales tax or remitting use tax on the assessed items.

FINDING

Taxpayer's protest of the negligence penalty is respectfully denied.

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